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MOVING TOWARD
SCHOOL FUNDING EQUITY:
IMPLEMENTATION OF HB 28

A Report to the 52nd Legislature
from the
Legislative Oversight Committee on
School Funding Implementation

Prepared by Andrea L. Merrill, Staff Researcher

Montana Legislative Council
Room 138, State Capitol
Helena, MT 59620

December 1990

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HOUSE BILL NO. 28 STUDY RESOLUTION

House Bill No. 28, June 1989 Special Session, read in part:

"Section 54. Legislative oversight committee on school funding implementation -- composition and appointment. (1) There is a legislative oversight committee on school funding implementation.

(2) The committee consists of 11 members, including:

(a) four members of the house of representatives appointed by the speaker of the house;

(b) four members of the senate appointed by the committee on committees of the senate;

(c) the superintendent of public instruction or his designee as an ex officio nonvoting member;

(d) a member of the board of public education as an ex officio nonvoting member; and

(f) the governor or his designee as an ex officio nonvoting member.

(3) No more than two legislative members from each house may be of the same politica! party.

Section 57. Duties of the committee. The duties of the committee include but are not limited to:

(1) monitoring the implementation of school funding equalization, including:

(a) identification of any problems of implementation and options for resolving these problems;

(b) continued analysis of school district budget and expenditure data and of improvements in school district accounting and reporting procedures; and

(c) examination of other issues related to implementation;

(2) directing the following studies of issues related to school funding equalization:

(a) school transportation equalization, including but not limited to:

(i) mechanisms to equalize transportation funding; and

(ii) analysis of issues related to the costs and efficiencies of school transportation, including reimbursement schedules, load requirements, 3-mile limit, transporting ineligible transportees, functions of the county transportation committee, and school district reporting and budgeting duties;

(b) school district capital outlay and debt service equalization, including but not limited to:

(i) analysis of school district funds and budgets for various school district capital outlay and debt service obligations; and

(ii) options for equalizing school district capital outlay and debt service obligations; and

(c) continued study of issues related to equalization, including but not limited to comprehensive insurance, uncollected taxes, tuition, student-based funding distribution methods, special education funding, administrative costs of school services, status of and approval process for isolated schools, options for reorganization or unification of school districts, and federal Public Law 81-874 revenue, especially as it pertains to revenue not linked to Native American students;

(3) ongoing analysis of revenue sources related to school funding;

(4) holding discussions with any party contemplating litigation regarding compliance with the supreme court and district court rulings on school funding equalization;

(5) reporting its findings, options for legislative consideration, and any proposed legislation to the governor and the 52nd legislature; and

(6) considering options of how the state can share teacher salary costs due to the salary change of teacher transferring from one school district to another. Currently, there is a problem of teachers transferring to other school districts. One reason is that most school districts will recognize no more than 5 years of a teacher's experience to base the new salary on, regardless of more years of teaching actually taught. This leads to hindering a teacher from transferring to another school district due to the disparity in salaries.

Section 58. Staff assistance. The committee may request the following governmental entities to provide staff assistance to the committee:

(1) the office of public instruction;

(2) the governor's office of budget and program planning;

(3) the board of public education;

(4) the legislative council;

(5) the office of the legislative fiscal analyst; and

(6) the office of the legislative auditor."

SUMMARY OF COMMITTEE RECOMMENDATIONS

The Legislative Oversight Committee on School Funding Implementation recommends that the 52nd Legislature:

- Adopt LC 306, draft legislation by request of the Committee to establish and fund a Montana educational telecommunications network (METNET).

- Adopt LC 62, draft legislation by request of the Committee containing the following provisions: technical changes related to the newly implemented school funding provisions and to implementation of generally accepted accounting principles (GAAP) for school districts; and allowing a district to amend the adopted general fund budget and to exceed any applicable budget limitation under certain conditions.

- Adopt LC 819, draft legislation by request of the Committee to appropriate $5 million biennially to the Board of Public Education to use for capital outlay grants to school districts most in need of capital expenditures to meet the accreditation standards.

- Adopt LC 820, draft legislation by request of the Committee to standardize the funding mechanism for funding elementary and high school district on-schedule transportation costs and to share equalization of that funding between the state and the counties, with guaranteed tax base aid for counties that are below the statewide average mill value per average number belonging.

- Not adopt any legislation that would freeze the growth of school district general fund budgets or reduce the 104% limitation on the growth of general fund budgets, as such action would further erode local control of school districts.

MOVING TOWARD SCHOOL FUNDING EQUITY: IMPLEMENTATION OF HB 28

INTRODUCTION

Each of the major sections of this report listed below is further divided into related components. For all but the first section, each component is discussed in terms of background information and any interim action by various parties, including the Legislative Oversight Committee on School Funding Implementation (Committee). The draft legislation, LC 62, LC 306, LC 819, and LC 820, recommended by the Committee is covered in various sections. The draft bills are not included in this final report but will accompany distribution of the report.

1. History of the school funding lawsuit and legislative reactions;
2. Elements of the new school funding mechanism;
3. Changes in school funding revenue sources;
4. Other components of House Bill No. 28 (HB 28);
5. Equalization of school transportation and facility funding; and
6. Additional HB 28 study topics related to school funding equalization and implementation.

1 HISTORY OF THE SCHOOL FUNDING LAWSUIT AND LEGISLATIVE REACTIONS

1.1 Initial Study: On July 1, 1990, school districts across the state commenced the first school year under a revised system of funding public elementary and high schools. However, the legal and legislative events leading to change spanned the preceding decade and culminated in the summer of Montana's centennial year, 1989.

As early as the 1981 legislative session, the warning shots of a school funding lawsuit were fired. A 1981-82 legislative interim study was commissioned to investigate the allegation that the decades-old funding system was seriously underfunding the real and mandated costs of operating the state's school districts.[1] That committee sought the advice of the nation's leading school finance experts and analyzed the funding disparities among the county retirement levies and among the district general fund (GF) budgets. As a result, the committee recommended that the 1983 Legislature improve equalization of the nonvoted portion of district GF budgets by eliminating the permissive levy area of GF budgets (2nd tier of funding) and refinancing that level of support through increases in the basic county equalization mills (first tier of funding). Additionally, the committee recommended that the Legislature promote more equitable financing of the voted area of GF budgets (third tier of funding) by enacting a guaranteed tax base (GTB) program.[2] After intense debate, the 48th Legislature's final equalization solution was to increase the basic county equalization levies by a total of 5 mills and to retain but reduce the permissive mills a commensurate 5 mills.[3] (See Appendix A for comparison of previous and new funding mechanism.)

1.2 <u>School Funding Lawsuit -- Legislative Reaction:</u> In April 1985, a coalition of 64 public school districts and parents of students in those districts filed a lawsuit in the Montana District Court system claiming that the state's system of public school financing violated the fundamental constitutional rights of persons to equal protection of the law and to equal educational opportunity.[4] In the following months, lawmakers attempted to forestall the lawsuit by encouraging the defendants--the State of Montana (State), the State Superintendent of Public Instruction (Superintendent), and the Board of Public Education (Board)--and the plaintiffs to negotiate an out-of-court settlement, with the Legislature as part of the mediation process.[5]

In an attempt to track the progress and issues of the lawsuit, the Legislative Finance Committee appointed the School Funding Subcommittee

(Subcommittee). The measures recommended to the 1987 Legislature by the Subcommittee were short of an overhaul of school funding.[6] However, through sponsorship of House Joint Resolution No. 16, the Subcommittee set in motion a review and redesign, by the Board and the public, of the school accreditation standards. The Subcommittee wanted to be prepared to respond in the event that a court or the Legislature might decide to use the accreditation standards as the basis for a definition of a basic system of schools upon which funding changes might be built.[7]

Since neither an out-of-court settlement nor a comprehensive funding reform package materialized during the 1987 session, the plaintiffs proceeded with their case, which began in May 1987 before District Court Judge Henry Loble.

1.3 **District Court Decision:** The six-week trial involved what some described as a "U-Haul load" of data and testimony from witnesses across the state and from nationally recognized experts on school programs and funding. The "Loble decision", upholding the plaintiffs' position, was handed down January 13, 1988.[8] The school funding system was found to deny students their constitutional rights to both equal protection under the laws and equality of educational opportunity. Judge Loble retained jurisdiction and delayed the effective date of his findings until October 1, 1989, in order to provide the Legislature with the opportunity to devise and enact an equitable system of school funding. He did not interject specific remedies but did suggest a focus on equalizing per-pupil expenditures within ranges of similarly sized districts, with exceptions for educationally relevant differences. Various legislative committees, confronted with the vast implications of the Loble ruling, urged the State and other defendants to appeal the decision to the Montana Supreme Court (Supreme Court).[9]

1.4 **Supreme Court Decision -- Legislative Response in 1989 Regular Session:** The State's appeal was heard before the Supreme Court in November 1988. During that fall, the impending decision hung like the

sword of Damocles and prompted formation of a number of public forums and studies to seek consensus on appropriate governmental responses.[10]

The 1989 Legislature was barely settled in for a long, hot winter when, in February, the Supreme Court shook the Capitol pillars with its concurrence in the Loble decision that the Montana school finance system was indeed unconstitutional. A mild aftershock followed as the Court gave the Legislature six months to fix the problem.[11]

The leadership of the House of Representatives promptly appointed the House Select Committee on Education to hear all major school funding reform legislation. Committee staff developed and continuously updated a series of charts that compared school funding components, various legislative proposals, and the education community's consensus points.[12] Senate Bill No. 203 emerged as the compromise package and survived until the final hours of the regular session, when lawmakers deadlocked on the bill's taxation measures. Having failed to resolve the school funding dilemma in the regular session, the 51st Legislature adjourned on April 21, 1989, only to be summoned back to Helena six weeks later to address the issue once more.

1.5 <u>June 1989 Special Session Results:</u> Governor Stephens called for a special legislative session to begin June 19, 1989. Only 11 days remained in which to devise a school funding scheme before the Supreme Court's July 1, 1990, deadline threatened to curtail school district activity.

In late June, the Legislature narrowed the field of funding options to one: Senate Bill No. 26, a plan the Governor threatened to veto. That bill would have increased statewide equalization levies to 100 mills, frozen the budgets of higher-spending districts, and equalized teacher retirement costs with state equalization aid. The education community supported most of the bill's provisions. Following a veto of SB 26 by the Governor, the Supreme Court extended its deadline for the Legislature's enactment of an equitable

system of school funding to July 17, 1989. With reprieve in hand, the Legislature tried once more to fashion a compromise plan, this time combining the GTB program in House Bill No. 39 with House Bill No. 28, which had passed the House of Representatives in a much-amended form. As final action concentrated in the Senate Education Committee at the end of the first week of July, a plan jelled to allow "revenue neutrality" for the oil, gas, and coal industries by repealing the property tax on those resources and instating a "flat tax" or local government severance tax on the gross value of this production.

The Legislature passed an amended HB 28 and adjourned on July 14, 1989. The Governor signed the bill on August 11, 1989, opining that despite many flaws, the plan did advance equalization and "was the least costly" of any of the proposals seriously considered in either session.

Three days after adjournment, the Supreme Court ordered both sides in the dispute to comment on the likely effects of HB 28. Plaintiff school districts took that opportunity to stress the following points:

- that since equalization of school capital outlay and transportation was not addressed in HB 28, the Supreme Court should postpone the effective date of the declaration of unconstitutionality on these issues until July 1, 1991, to allow the 1991 Legislature an opportunity to repair these funding areas;

- that the effective date of constitutional issues covered in HB 28 should be postponed until July 1, 1990, when the new plan became operative (the State also supported this point); and

- that HB 28 gave little promise of equalizing per-student GF spending disparities or employee benefit costs covered by the county retirement levies.[13]

1.6 Final Supreme Court Action: On January 4, 1990, the Supreme Court delayed the effective date of its previous ruling until July 1, 1991, and relinquished jurisdiction over the school funding case, requiring future challenges to be initiated in District Court. The Supreme Court felt the delay would permit the 52nd Legislature to appraise and possibly refine the new funding system.

2 ELEMENTS OF THE NEW SCHOOL FUNDING MECHANISM

2.1 Foundation Program Funding Increased: The foundation program (FP) funding mechanism was enacted in 1949 to provide districts with equalized revenue per average number belonging (ANB), to be distributed through the FP schedules.[14] In the past decades, this first funding tier for district GF budgets was funded through 45 mills of county equalization aid, supplemented by state equalization aid from various revenue sources (20-9-343, MCA). (See Appendix A for chart showing previous and new school funding mechanism.)

While the funding distribution mechanism has remained static over the years (except for legislated percentage increases in the schedules), the original FP revenue collection and equalization scheme has undergone numerous changes.* In fiscal year (FY) 1950, the foundation program met its design specifications by funding 81.2% of the total district GF budgets in the state. Plaintiff testimony in the school funding lawsuit revealed that in FY 1986, the foundation program funded only 58% of statewide elementary school GF budgets and 54% of high school GF budgets.[15] By FY 1988, FP funding covered merely 50% of total GF budgets of the state's districts.[16]

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* The FP schedules were not adjusted regularly to mesh with studies of actual GF budget expenditures. Rather, the Legislature often linked schedule increases to the health of the state budget and economy or the inflation rate. The last schedule increase prior to funding reform for the FY 1990 school fiscal year was 1% for FY 1987.

The Supreme Court ruling upholding the decision in Helena Elementary, the education community, and previous legislative studies had all suggested as an appropriate goal the equalization of at least 80% of any district's GF budget. In an attempt to move toward this goal, a legislative commitment developed during the 1989 Regular Session to disperse through the FP schedules an amount equal to at least 80% of the GF and comprehensive insurance fund expenditures of all the districts in the state in FY 1988.[17]

In the final hours of the June 1989 Special Session, negotiations resulted in a 13.9% increase in the FY 1991 (over FY 1990) elementary schedules and a 21.5% increase in the high school schedules, with an additional increase of 8.7% for elementary districts with an ANB count over 300.[18] Higher schedule increases in HB 28 had been approved by both House and Senate action, but the final downward adjustment was in reaction to the passage of House Bill No. 6, with its 3% schedule increase for FY 1990.[19] The FP schedule increases from both bills resulted in a $67.2 million expansion in the level of state funding--$7 million for FY 1990 plus $60.8 million more in FY 1991.*

2.2 Guaranteed Tax Base Program: Under HB 28, a state GTB program provides support for permissive mill levies for school districts and for county retirement levies if the adjusted taxable value per ANB of the district or county is less than the adjusted state average taxable value per ANB.[20] The state support for GTB aid to districts and counties in FY 1991 was predicted to cost $28.5 million. However, for the first year of implementation (FY 1991), the preliminary estimate is $30 million in aid to districts and another $14 million to counties. See page No. 19 for further information on GTB aid for county retirement levies.

Interim Action: The Superintendent adopted rules for GTB eligibility and calculations.[21] For the first year of implementation, the adjusted GTB

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* A total of $347.9 million for FY 1991 compared to $287.6 million for FY 1990.

statewide mill value per ANB is $19.81 for elementary districts and $48.94 for high school districts. The adjusted GTB statewide average for the county elementary retirement levy is $19.66, and the average for the county high school retirement levy is $48.96.[22]

2.3 Permissive Amount and Levy: Under the revised school funding equalization plan, trustees of a district may adopt by resolution a GF budget of up to 135% of the district's FP amount. This new "permissive amount" (35% beyond the FP amount) may be financed by a district levy, by other nonlevy revenue available to the district, or by any GTB aid that the district is entitled to if the district's mill value per ANB is less than the statewide mill value per ANB.

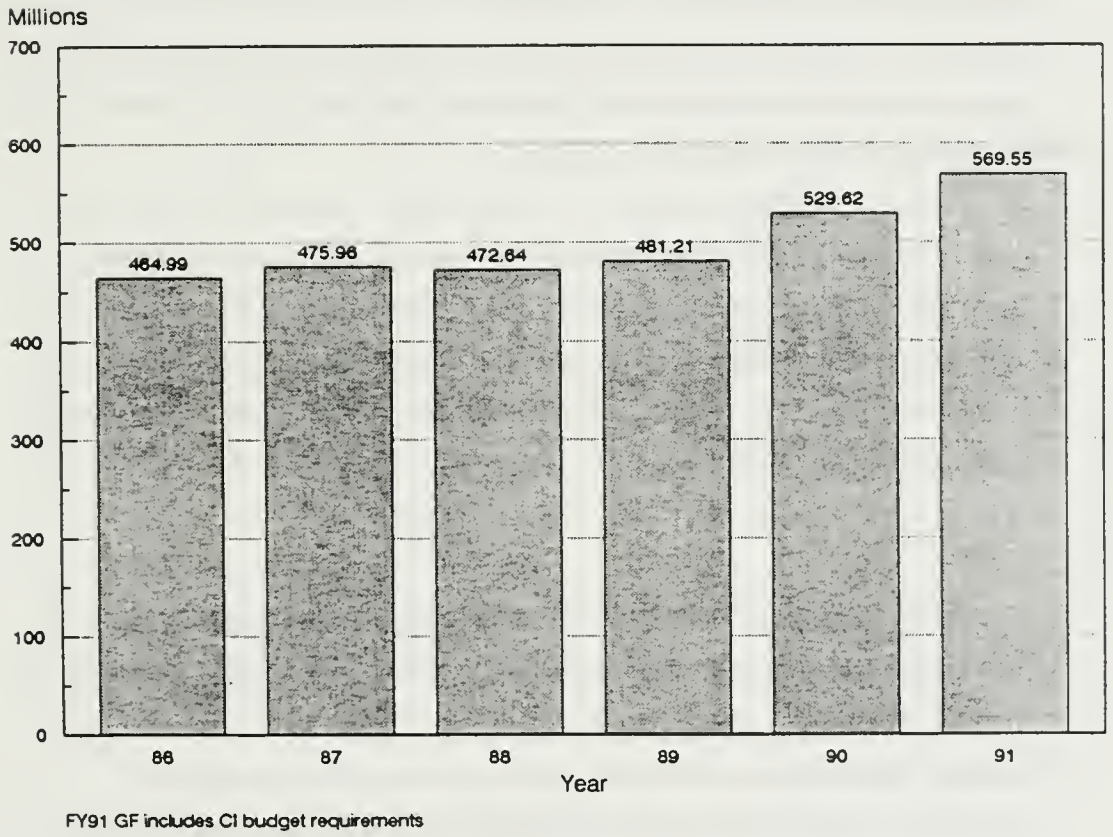
The 135% figure was derived from legislative negotiations in the final hours of the June 1989 Special Session. The commitment was to equalize school funding to the same level that all of the state's districts spent in their FY 1988 GF and comprehensive insurance budgets combined and also to equalize an additional amount (12%) that could represent inflation's toll on school GF budgets from FY 1988 to FY 1991, the year of implementation. This concept is bracketed in HB 28 as "112% of FY 1988 district general fund and insurance fund expenditures". This calculation was meant to express legislative intent to equalize 82.5% of the FY 1988 district GF and comprehensive insurance fund expenditures through the FP amount, with the remaining 17.5% plus an inflation-related amount of 12% to provide equalization through a permissive amount funded by GTB aid. This can be illustrated as 112% divided by 82.5% = 135%. Stated another way, the FP amount was projected to cost $378 million in FY 1991, a figure that is equivalent to 82.5% of FY 1988 combined district GF and comprehensive insurance fund expenditures of $458 million.

It follows from the above discussion that if all of the eligible districts availed themselves of the full permissive opportunity, statewide district GF spending in FY 1991 would increase by at least 12% over what was spent

in the GF and comprehensive insurance fund budgets of districts across the state in FY 1988. The growth in district general fund budgets from FY 1986 to FY 1991 is shown in Figure 1. The graph illustrates that general fund budgets have grown 18% from FY 1989 to FY 1991.

Figure 1

School District General Fund Budgets
FY86 to FY91



Source: Office of Public Instruction

The provisions of HB 28 increased the state share of funding for district GF budgets from 55% in FY 1988 to 72% in FY 1991. When the district share of the 35% permissive area is added to the state FP and GTB aid, approximately 81.2% of district GF budgets are funded with equalized

revenue. Because GTB aid for the permissive area guarantees 35% of the FP amount, any increases in the FP schedules or special education allocations also increases the state GTB aid obligation.

Interim Action: In March 1990, the Superintendent adopted rules governing the permissive amount.[23] Clarifications of statute included a definition of "other revenue" and a formula for determining eligibility for GTB funding. The rules reiterated the statutory requirement contained in 20-9-367, MCA, that a district must levy mills to generate GTB aid. A district is not required to use Public Law 81-874 funds (federal impact aid) to finance the permissive amount, but it may do so if it chooses. This option for use of Public Law 81-874 funds may be attractive to districts with generous federal impact aid and with few local property taxpayers from whom to collect the millage that would generate GTB aid.

During the 1990 preliminary budgeting process, some taxpayers objected to a school board's ability to invoke permissive mills without a vote of the district electorate. In requests for interpretation on what some considered ambiguities in this area, the Attorney General ruled that there was clear authority for district trustees to use a nonvoted, permissive levy as a means of reaching the 135% funding level.[24]

At the September 28, 1990, meeting of the Committee, members approved the following technical corrections to be included in LC 62: amend 20-3-324, 20-9-141, 20-9-301, 20-9-315, and 20-9-353, MCA, to clarify the status of the permissive amount and permissive levy; substitute bracketed language in 20-9-145 and 20-9-315, MCA, with "35%" and "135%", respectively; and simplify language describing "permissive amount" in various sections.

2.4 General Fund Budget Caps: In the statement of purpose within HB 28, the Legislature recognized the need to balance the constitutional guarantee of equal educational opportunity, as upheld by the Supreme Court,

with the constitutional empowerment of trustees to supervise and control local schools.[25] In addition, the Legislature acknowledged that it is reasonable and necessary to permit a range of disparity in expenditures by similarly sized districts because different educationally relevant circumstances exist. The establishment of a maximum GF budget limitation melds these concerns. The maximum GF budget is limited to the greater of 104% of the previous year's GF budget or 135% of the current FP amount. A district is not required to use current year's receipts of Public Law 81-874 money within either cap.

Testimony in the school funding lawsuit revealed that disparities in district GF spending per ANB for FY 1986 ranged as high as 8 to 1 within one category of similarly sized districts.[26] For most categories, the range of disparity was about 2 to 1. While access to equalized funding for district GF budgets has increased from 55% in FY 1988 to 72% in FY 1991, preliminary data from FY 1991 GF budgets indicates that the disparity ranges for per-ANB spending among similarly sized districts remain wide. An thorough analysis by the Office of Public Instruction of FY 1991 district budgets and other implementation results was not available for the final meeting of the Committee but the analysis will accompany the distribution of this report.

Interim Action: During the interim study process, the Committee became aware of the following limitations of the new capping devices:

- As many as 60 of the state's 545 districts used the emergency budget process in FY 1990, generally to clear that year's accounts in preparation for the use of generally accepted accounting principles (GAAP) or to purchase computer power to support the new accounting system.

While districts received some criticism for this,* spokespersons pointed out that future use of emergency budgets was limited by the new caps.

- A district may exceed its reserve limit with settlement funds from protested taxes but may not use the money to exceed its GF budget cap. This HB 28 provision may prohibit the use of tax settlement money in one year for substantial projects, such as construction, repairs, or other deferred projects.

- A district that receives hard-rock mining impact funds under 90-6-310, MCA, collects the funds on a sliding scale. As the funding from this source decreases, the district may need to fund certain on-going expenditures once covered by the district metal mines tax reserve account (20-9-231, MCA) as part of its GF operating budget.

- A district may receive special education contingency funds from the Office of Public Instruction (OPI) for unanticipated enrollments or for changes in student needs, but if the district is at its cap, the changes cannot be amended into the next year's GF budget.

- A district may experience an emergency, such as a fuel spill, for which it receives special funds to be spent on long-term abatement. Again, if the district is at its cap, such special funds cannot be added to the budget base for ensuing years.

At the September 28, 1990, meeting of the Committee, OPI suggested, as a solution to the above situations, that the emergency budget process be changed to a more generic "budget amendment" process and that districts be allowed to amend, by school board resolution, adopted GF budget up to the level of any applicable GF budget cap. Any budget

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* Districts that approved emergency GF budgets in FY 1990 had a higher than anticipated GF budget base to build upon for the first year of implementation of GF budget caps.

amendment expenditures above the cap would require approval of the Superintendent. The Superintendent would also determine if the additional expenditures could become part of the budget base against which the 104% cap is calculated for the following school fiscal year. At the December 1, 1990, meeting, the Committee included this concept in LC 62 by amendments to 20-9-161 through 20-9-166, MCA, and New Section 50.

Also at the December meeting, the Committee discussed how the present budget capping mechanism may work against the goal of achieving equalization of per-pupil spending. A number of school district spokespersons stressed that lowering or freezing the 104% cap would be double jeopardy for districts that must cope with the current inflation rate (over 6%) and newly-mandated accreditation standards. The Committee considered the recommendation of Superintendent Keenan that it is difficult to judge what changes would be appropriate remedies when only preliminary budget data is available from the first year of implementation. The Committee recommended that the 52nd Legislature not adopt any legislation that would freeze the growth of school district general fund budgets or reduce the 104% limitation on the growth of general fund budgets, as such action would further erode local control of school district.

2.5 Public Law 81-874: During the study process, a number of issues emerged regarding state and district use of federal Public Law 81-874 money:

- Should a district be required to count any portion of its Public Law 81-874 receipts that are considered "revenue in lieu of property taxation" as nonlevy revenue for GTB purposes?

- Should a district be allowed to use a portion of its Public Law 81-874 receipts to replace mills for generating GTB aid.

- Has enough school funding equalization occurred for the state to consider equalization of these federal funds in some manner? If not, should the state pursue that goal by improving equalization enough to meet the federal tests of either 85% wealth neutrality or a 25% expenditure disparity for all school spending?

Interim Action: At the November 15, 1990 meeting of the Committee, a staff report to the Committee discussed the additional concern that HB 28 in effect requires districts to reappropriate remaining Public Law 81-874 funds as general fund dollars from one year to the next in a manner that may be in violation of federal regulations. States are prohibited from taking federal impact aid into consideration in allocating state school aid funds.[27] The Committee did not act on issues in this area.

2.6 General Fund Reserve Limits: The district GF budget reserve amount is limited by the level of state equalization aid payments received by the district in the following manner: the reserve amount may not exceed 20% if state aid is over one-quarter of that amount; the reserve amount may not exceed 30% of the GF budget if state aid is one-quarter or less of the district FP amount; and the reserve amount may not exceed 35% if a district receives no state equalization aid. Under current law, a district may exceed the statutory reserve limit with Public Law 81-874 money, consolidation bonuses, and the unused balance of settlements from protested taxes. Revenue exceeding the applicable reserve limitation is considered cash reappropriated and, according to ARM 10.22.104, must be used first for reduction of property taxes in the permissive area, and secondarily to reduce any voted amount, in ensuing fiscal years. In the first year of HB 28 implementation, a number of districts used excess reserves as cash reappropriated, which may have reduced the demand for GTB aid.

Interim Action: In March 1990, the Superintendent adopted rules governing the use of reserves.[28] At the September 28, 1990, meeting, the Committee approved technical corrections to LC 62 to clarify that a district

may exceed the reserve limit with any combination of sources listed above in paragraph 2.6. (See also, section 20-9-104(3), MCA.)

2.7 **Foundation Program Redefined:** The foundation program is newly defined to include each district's total schedule amount as described in 20-9-316 through 20-9-320, MCA, and any state payments in support of special education programs as described in 20-9-321, MCA.*

2.8 **Special Education Funding:** House Bill No. 100 of the 1989 Regular Session appropriated $33.86 million in special education funding for the 1990-91 biennium. This increase of 20% over the previous biennium's state commitment was an attempt to more fully fund special education as part of the equalization package.[29]

2.9 **Funding Days Limited:** Foundation program schedule funding was limited to 180 pupil-instruction days and 7 pupil-instruction-related days each school fiscal year. Schools still have the choice of conducting school for more calendar days. This limitation mitigates any disparity in distribution of equalized funding that may result from the variation in local district choices on the length of the school year.[30]

2.10 **District Comprehensive Insurance Fund Abolished:** Most discussions or reports on school funding reform had urged simplification of the school budgeting and funding process.[31] House Bill No. 28 abolished the district comprehensive insurance fund and its nonvoted levy and included the costs in the district general fund.[32] This fund covered district liability and personal property insurance as well as workers' compensation insurance premiums.

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* Prior to HB 28, the statutory schedules were called the maximum-general-fund-budget-without-a-vote amount, with 80% representing the FP amount and 20% for the permissive amount. The allowable costs for special education were included in a district's total maximum-general-fund-budget-without-a-vote amount.

2.11 State Equalization Payment Schedule: Under 20-9-344, MCA, the Board may adopt policies to guide OPI distribution of 20% of any state equalization aid and GTB aid by July 15 of the school fiscal year, followed by monthly payments of at least 7%.

Interim Action: The Board, on the advice of OPI, adopted the required rule change and ordered that the FY 1991 distributions of state equalization aid and GTB aid be sent on the final business day of the month.[33] The provision in 20-9-2, MCA, requiring that county treasurers invest incoming equalization money to the credit of the appropriate district within three working days mitigated some concern over the distribution dates. For the FY 1991 year of implementation, distribution of the first GTB payment was not possible until final budgets and mill levies were set in August and reported to OPI for payment in October. In future years, an estimated amount can be distributed to eligible districts based on their previous year's GTB aid.

2.12 Equalization of County Retirement Levies: The county retirement levy covers the contributions of all districts in the county to the Teachers' Retirement System, the Public Employees' Retirement System, Social Security, and state unemployment insurance. For FY 1988, the statewide total for this obligation was $52 million. County elementary and high school retirement funds were budgeted for $66.4 million in FY 1991.

Under the new funding package, GTB aid is provided for any county that is below the state average in taxable valuation per ANB.[34] (See page No. 7 for an explanation of the GTB program.) Lottery money dedicated to equalization of the county retirement levy by the 1987 Legislature[35] was diverted to the state equalization aid account.

Evidence in the District Court trial revealed that FY 1986 county retirement levy mills ranged from 2 mills for Fallon County to 51 mills for

Daniels County. Information for FY 1991 on the disparity range among county retirement levies was not available upon publication of this report.

3 CHANGES IN SCHOOL FUNDING REVENUE SOURCES

3.1 State and County Equalization Levies: House Bill No. 28 instituted as a source of revenue for state equalization aid a statewide levy of 40 mills, with estimated revenue generation of over $60 million a year. Basic county equalization levies were increased from 45 mills to 55 mills (33 mills for elementary districts and 22 mills for high school districts).[36] State equalization aid was pledged for any loss to county equalization levies from protested taxes. The statewide mills and all other state equalization aid sources were statutorily appropriated in 20-9-361, MCA.

3.2 Additional Revenue Sources: House Bill No. 28 supplied the following sources and estimated amounts of state equalization aid revenue: the net income from the lottery, previously shuttled to equalize county retirement levies--$4.6 million; a 5% education surtax on individual income--$13.4 million--and on corporate income--$2 million (effective only for calendar year 1990);* and an increase in the percentage of income tax revenue that is deposited in the state equalization aid account--$22.8 million. The education trust fund established from coal severance tax collections was abolished, and the balance in the fund rerouted to state equalization aid. Additionally, 15% of the interest from the coal tax permanent trust provided for in 17-5-704, MCA, and 11.4% of the total coal severance tax in 15-35-108, MCA, was also earmarked for state equalization aid.

3.3 Local Government Severance Tax/Flat Tax on Oil, Gas, and Coal: To ensure that mineral producers were held harmless from substantial additional taxes due to increased millage for school equalization purposes,

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* A statement in HB 28 declared the income surtax to be "in lieu of a general sales tax".

the existing property taxation of oil, natural gas, and coal production was repealed and replaced with a local government severance tax, or "flat tax", on the gross value of production of these minerals.[37] A number of inadvertent flaws in the new flat tax and local government severance tax statutes required correction in a second special session of the 51st Legislature, which was held May 21 through May 25, 1990. The problems and corrections adopted appear in Appendix B.

As a consequence of this taxation change, some counties and their taxing jurisdictions lost over 50% of their property tax base. Statewide, the loss was close to $400 million in taxable valuation. The loss of various property tax revenues may act as a cap to district budgeting and thus has the potential of narrowing district spending disparities.

3.4 Related Revenue Changes: During the June 1989 Special Session, the Legislature made a number of significant changes to Montana's property tax base in response to the consequences of school funding reform and other pressures. Effective for tax year 1990, property tax rates for various classes of personal property of businesses were reduced, which lowered the statewide tax base by $52 million.[38] For FY 1990, taxing jurisdictions received replacement revenue from the state general fund based on projected losses in revenue. Counties and districts must include the replacement revenue as nonlevy revenue when computing the final amounts to be raised by various school levies.

3.5 School Levies Exempt From Initiative Measure No.105: House Bill No. 28 exempted all school district levies from Initiative Measure No. 105, which had frozen the property tax levies of local taxing jurisdictions at 1986 levels.[39]

4 OTHER COMPONENTS OF HOUSE BILL NO. 28

4.1 Generally Accepted Accounting Principles: House Bill No. 16 (Chapter 1, Special Laws of 1989), requiring schools to comply with GAAP, was approved in the June 1989 Special Session before the passage of HB 28, which contained similar provisions. Under both bills, the Board may order OPI to withhold state equalization aid payments if a district fails to maintain accreditation status or to submit reports or budgets as required by law, which would include adherence to GAAP requirements.

Interim Action: Following review of the Board's proposed rules at the Committee's May 12, 1990, meeting, the Committee encouraged the Board to adopt rules that would motivate school districts to convert to GAAP and to supply reports to OPI in a timely manner. The Board adopted rules in June 1990 that allow the Superintendent to notify the Board if financial reports are not received within 35 days of initial notice to the district.[40] Upon notice of a violation, the Board shall determine at a hearing whether or not substantial reason exists to withhold state aid.

An OPI survey of districts in late 1989 revealed that approximately 55% were operating on a cash basis and would need assistance converting to GAAP. House Bill No. 28 appropriated $353,950 to OPI to establish standard accounting and reporting practices in all Montana school districts and to implement the act. The Office of Public Instruction allocated $204,000 of that amount to hire accountants to provide GAAP workshops and to update the school finance and accounting manual. A continual training program will be required. The Superintendent also adopted rules for district implementation of GAAP.[41] At the September 28, 1990, meeting, of the Committee, members supported amendments to various sections of Title 20 to comply with GAAP.

4.2 Bonus Payments for District Consolidation: The FP schedule increases that were amended into HB 28 at various times during the

compromise process may have been substantial enough to discourage several districts from consolidating as planned because districts would have garnered more FP schedule aid if the districts' ANB counts were not merged. The bonus payments provided to consolidating districts were increased by 50% to keep this program an attractive incentive to district mergers.

4.3 Other Technical Corrections: At its September 28, 1990, meeting, the Committee recommended that the following amendments be included in LC 62:

- amend 20-9-141, MCA, to clarify computation of the GF net levy requirement for a district receiving GTB aid. Amend 20-9-501, MCA, to calculate the net levy requirement for a county receiving GTB aid;

- amend 20-9-366, MCA, to separate "statewide county mill value" from "statewide district mill value" and make related changes;

- amend 15-24-1402, MCA, to clarify that the tax incentives for new or expanding industries provided in that section do not apply to the 40-mill state equalization levy;

- amend 20-9-360 and 20-9-361, MCA, to remove obsolete language regarding exemptions for municipal tax increment financing; and

- repeal 15-10-103, MCA, an obsolete reference to the "state deficiency levy for schools".

5 EQUALIZATION OF SCHOOL TRANSPORTATION AND FACILITY FUNDING

5.1 Transportation: Even though the various court decisions did not contain a clear mandate to equalize transportation costs, the indication is

strong that those costs are part of the basic system of education. A number of funding reform proposals in the 1989 Regular and Special Sessions would have provided full state funding of the established school transportation schedules for eligible transportees. However, a lack of detailed analysis of the issues and sparse testimony gave strength to the notion that the Legislature needed to invest more time and thought into changes in this area.[42] In both FY 1988 and FY 1989, the state transportation schedules required about $17 million in funding that is shared among the state, counties, and districts. The districts spent another $16.5 million to fund any over-schedule transportation needs. This total does not include transportation expenditures for sports or other extracurricular activities, which must be funded through the district GF budget.

Interim Action: The Committee heard reports on "who controls what" in school transportation, how the transportation funding system works, and how other states fund transportation.[43] The Committee and OPI acknowledged the difficulties of addressing equalization of transportation costs until improvements are made in district budgeting and reporting. As a first step, OPI suggested standardizing the revenue sources and reimbursement mechanism for elementary and high school districts.

At its May 12, 1990, meeting, the Committee requested draft legislation to limit transportation funding to 180 pupil-instruction days to match the similar 180-day limitation of state equalization aid in HB 28. The Committee approved the addition of this amendment to LC 62 at the September 28, 1990, meeting. The following technical amendment was also adopted: to amend the definition of "eligible transportee" in 20-10-101, MCA, to allow district transportation and reimbursement for preschool handicapped children from three to six years of age, to coordinate with the mandate in 20-7-411, MCA, that each district must provide a preschool special education program for the 1990-91 school year.

The mileage rates for transportation reimbursement in 20-10-141 and 20-10-142, MCA, were last increased by the 1983 Legislature for the FY 1984 and FY 1985 school years. Until recently, the education community has not formally requested an increase, possibly due to the stability of fuel prices. However, current geopolitical events suggest that the price of fuel for school buses for the FY 1991 school year may trigger requests for increases in the mileage rates in the transportation schedules. At the September 28, 1990, meeting, OPI reported on fuel cost predictions for the current and ensuing school years and suggested that district transportation reserves could be ample enough to finance moderate increases in fuel costs in all but 55 districts.[44]

At the November 15, 1990, meeting of the Committee, members discussed the following options as analyzed by OPI:[45]

- 100% state funding of on-schedule transportation costs ($7.3 million increase in state aid).
- Funding of on-schedule transportation costs shared equally among the state, county, and districts with GTB aid for county share ($3.6 million decrease in state aid).
- 50% state funding and 50% district funding of on-schedule transportation costs, with GTB aid ($3.1 million increase in state aid).

At its December 1, 1990, meeting, the Committee recommended draft legislation (LC 820) to share the districts' on-schedule transportation costs of $18 million between the state and the counties, with GTB aid for counties. As recommended by OPI, the elementary districts and high school districts would be funded in the same manner. This option would result in a $3.1 million increase in state aid.

5.2 <u>Equalization of School Facility Funding:</u> Currently, funding for school capital outlay and debt service is totally dependent on local district resources and comprises approximately 5% of total spending in all district

budgets. During the stages of the school funding lawsuit, plaintiffs and defendants alike sought court clarification on whether the state was required to equalize school facility funding. No proposal surfaced in the 1989 funding reform dialogue that would infuse a state share of funding.

Interim Action: As part of the study plan, the staff of the Legislative Fiscal Analyst surveyed the state's school districts in December 1989 to discover the age and condition of existing buildings, the amount of outstanding bonds, district predictions of facility needs, the size and success of recent bond elections, and other pertinent information.[46] The results indicated that many of Montana's inadequate school buildings are concentrated in the state's poorest districts and that 4 of every 10 districts will need a new facility or extensive remodeling of existing facilities by FY 1996. The potential price tag for identified construction and remodeling approaches $177 million.[47] A discussion document on equalization of school facility funding highlighted that the price for equal access to funding can lead to state approval of projects and the loss of local district control.[48] At the September 28, 1990, meeting, an analysis of funding models was presented to both the Committee and the Revenue Oversight Committee.[49]* At the November 15, 1990, meeting, the Committee discussed methods of limiting state costs if GTB aid was used to equalize capital outlay expenditures for districts. The staff report also focused on the use of federal Public Law 81-874 and Public Law 81-815 funds for capital outlay.[50]

The removal of nearly $400 million from the property tax base available to school districts suggests that some districts may find themselves up against the statutory bonding limitation of 45% for future bonding commitments. At the September 28, 1990, meeting of the Committee, members recommended amending 20-9-406, MCA, to include in

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* House Bill No. 28 required the Revenue Oversight Committee to analyze effects of the GTB aid and how the GTB might be used to equalize school transportation and capital outlay costs.

the bonding limit, a calculation of the taxable value of coal gross proceeds, oil and gas net proceeds, and the local government severance tax. Despite this correction, it remains that losses in property valuation could severely limit the ability of some districts to pass facility bonding issues.

At its December 1, 1990, meeting, the Committee adopted a recommendation offered by the Superintendent to biennially appropriate $5 million to the Board to use for capital outlay grants to school district most in need of capital expenditures to meet the accreditation standards. The Board would be required to make an advisory report to the Legislative Finance Committee prior to any award of grant money. The Committee anticipated that during the 1991 Legislative Session, the House Appropriations Committee would enhance the Committee legislation (LC 819) by developing explicit criteria that would ensure that grants were used exclusively to meet the accreditation needs of districts with low property tax bases.

6 ADDITIONAL HB 28 STUDY TOPICS

The following issues related to school funding equalization were either included in the HB 28 study directive or emerged during the study process.

6.1 Tuition: The elimination of tuition charges among districts and between a student's parent and a district was discussed in some detail during the 1989 Regular Session because the concept was included in a number of funding proposals.[51] The most convincing reason for eliminating tuition was the belief that if a high proportion of the cost of educating students was fully funded by some equalized means, little incentive would exist for districts to exchange paperwork to collect a minor amount of tuition to cover any locally funded costs per ANB.

While the Committee took no final action on this issue, members did review an OPI report presented at the November 15, 1990, Committee meeting.[52] The report highlighted a number of issues that emerged during an examination of tuition:

- The loss of revenue from tuition would severely impact some school district GF budgets unless a high level of state equalization funding is maintained;

- The statutory provisions for tuition for special education, mandatory enrollment for out-of-district court-ordered placement and out-of-state students, as well as permission to waive tuition, do relieve pressures on both receiving and sending districts;

- School districts that have district courts resident within their boundaries face potential tuition cost burdens when the court terminates parental rights; and

- There is inequity in requiring elementary districts to finance tuition costs while providing county equalization funds for tuition for attending an out-of-county high school.

6.2 <u>District Organization:</u> Staff provided reports on district organization in Montana, student demographics affecting district organization, and the history of legislative attempts to influence the number and types of districts.[53] Committee members considered whether increased, uniform taxation among districts would contribute to grassroots efforts to consolidate districts or whether it would promote more cooperative ventures among districts as a way of conserving resources. At the May 12, 1990, Committee meeting, Dr. Ernest Jean, Superintendent of Florence-Carlton Schools, reported on advantages of allowing contiguous elementary and high school districts to unify under one set of budgets.[54] Fifty-three districts could be formed in this manner, with minor changes to

statute or to district activities. The Committee took no final action on this issue.

6.3 Encouraging District Cooperative Ventures: The Committee received a request from Representative John Cobb to consider ways of encouraging districts to engage in cooperative ventures, such as sharing of faculty or facilities.[55] Over the years, a number of districts in Montana have used the interlocal agreement process to form cooperatives for various activities.[56] Starting this school year, groups of districts have formed consortiums for the purpose of employing persons to plan and assess each district's curriculum for compliance with the new accreditation standards. The Committee did not request further investigation of various cooperative structures and statutory or other financial incentives for district cooperation.

6.4 Study Committee: The HB 28 statement of purpose recognized the need to address equalization of other school funding, such as transportation and capital improvements. A study was to "identify those factors that affect disparate expenditure patterns, to determine whether those factors are educationally relevant, and to develop data not currently available to devise methods of equitably funding those needs".

Interim Action: Following the study plan adopted October 16, 1989, the Committee monitored implementation of HB 28 and studied issues related to school funding equalization, with special attention to required rulemaking by OPI and the Board. The staff team worked together to prepare the information noted in this report. The Office of Public Instruction has stressed that implementation of GAAP will improve the reporting of other budget areas under Committee scrutiny, such as transportation, tuition, and debt service. A school funding oversight committee, with continued representation by education policymakers and with staff teamwork, could be a useful tool for the further study of funding equalization, related taxation issues, and public school education issues in general. The Committee did not take action on this topic.

6.5 Distance Learning Telecommunications Network: To promote the use of distance learning as a means of enhancing equal educational opportunity for Montana students, HB 28 appropriated $200,000 to the Department of Administration (Department) to hire a consultant to advise on the development and improvement of an in-state telecommunications network and granted the DOA $300,000 for the implementation of an educational telecommunications network, to be matched with $150,000 from private or federal sources.

Interim Action: To provide broad-based policy guidance to the project, the Montana Telecommunications Cooperative was formed in December 1989, with membership open to all public and private organizations interested in educational networks. Superintendent of Public Instruction Nancy Keenan served as chairperson. The Department contracted with Lambda Communications to provide a needs assessment, to design a network, and to move to initial implementation of an agreed-upon network plan. As reported at the September 28, 1990, Committee meeting, the recommended network plan has three action phases, the first of which will use the $300,000 to provide to each school, by June 1991, a modem to link personal computers and to provide at least 250 schools with satellite dishes capable of receiving telecourses.[57]

At its September 28, 1990, meeting, the Committee requested draft legislation to implement recommendations in the report from Lambda Communications to establish an educational network capability, to provide for appropriations, and to define operational and policy matters relating to the use of the network. At its December 1, 1990, meeting, the Committee recommended that the 52nd Legislature approve LC 306, incorporating the above concepts and a $300,000 appropriation each year of the coming biennium to the Department, with a $150,000 match from private or federal sources. The draft legislation was amended to include Department study of ways in which the Native American tribal colleges and other nonpublic

institutions could eventually interface with the educational telecommunications system.

ENDNOTES

1. House Joint Resolution No. 34, 1981.

2. Montana School Finance: A Question of Equity, A report to the 48th Legislature by the Joint Subcommittee on Education, Montana Legislative Council, November 1982.

3. In Chapter 418, Laws of 1983, the basic county equalization levy for elementary districts was increased from 25 to 28 mills, while the county equalization levy for high school districts went from 15 to 17 mills. The permissive levies were reduced from 9 to 6 mills for elementary districts and from 6 to 4 mills for high school districts. In addition, Chapter 629, Laws of 1983, used the increase in basic county equalization to raise the foundation program schedules by 4% for FY 1984 and by 3% for FY 1985.

4. See plaintiffs' complaint filed April 17, 1985, and subsequent briefs in Helena Elementary School District No. 1, et al. v. State of Montana, First Judicial District Court, Cause No. ADV-85-370.

5. Minutes of the Montana Legislative Finance Committee, in joint meeting with the Montana Legislative Council, Helena, Montana, November 22, 1985.

6. Minutes of the School Funding Subcommittee of the Legislative Finance Committee, Helena, Montana, December 1, 1986.

7. For results of House Joint Resolution No. 16, see Defining a Basic System of Education for Montana's Next Century, A report to the 51st Legislature by the Joint Interim Subcommittee on Basic Education, Montana Legislative Council, December 1988.

8. Findings of Fact, Conclusions of Law, Order and Judgment, January 13, 1988, Helena Elementary School District No. 1, et al v. State of Montana (hereafter, Helena Elementary). The decision presents a thorough picture of the contested school funding structure and can serve as a primer in a wide range of school finance issues and constitutional issues related to public education.

9. Minutes of the Legislative Finance Committee, Helena, Montana, January 21, 1988; minutes of the Joint Interim Subcommittee on Basic Education, Helena, Montana, April 30, 1988.

10. "Public School Funding Recommendations," a report to Montanans by the Governor's Public School Finance Advisory Council, Helena, Montana, November 16, 1989.

"Options for Equity: A Forum on Equalizing Education Resources in Montana," a conference sponsored by U.S. West, Helena, Montana, December 1988. A report by the same name was issued in early January 1989 and is a comprehensive view of the school funding issues and developing consensus points. For the above conference, the Montana Chamber of Commerce made available "Funding and the Loble Decision," a compilation of articles by key policymakers and interested persons, reprinted from Eye on Business, a publication of the Montana Chamber of Commerce.

11. Helena Elementary School District No. 1, et al. v. State of Montana, 236 Mont. 44, 769 P.2d 684 (1989). For an analysis of the decision, see the following:

"Supreme Court Upholds Loble Decision," by Bruce Moerer, Montana School Boards Association Hotline, No. 4, February 3, 1989.

Minutes of the Montana Senate Education Committee, "Summary of Supreme Court School Funding Decision," Exhibit No. 1, by Dave Cogley, Staff Attorney, Montana Legislative Council, Helena, Montana, February 3, 1989.

12. House Select Committee on Education, "A Summary of School Funding Proposals," reports prepared by the Montana Legislative Council staff, revised February 6, 1989, February 27, 1989, and March 27, 1989. These summaries were also created for proposals in the June 1989 Special Session and are part of standing committee minutes.

13. Plaintiffs' Petition, filed August 23, 1989, in Helena Elementary.

14. Foundation Program Act of 1949, Chapter 199, Laws of 1949.

15. Helena Elementary, page 52, Exhibit 27.

16. Minutes of the House Select Committee on Education, Montana House of Representatives, Helena, Montana, February 2, 1989.

17. Senate Bill No. 26, June 1989 Special Session, promoted equalization of 100% of the FY 1988 GF budgets of the state's districts. House Bill No. 28, as introduced, would have deducted from the FY 1988 amount 30% of the Public Law 81-874 money received by the state's districts. The rationale for the deduction was that since those funds could not be equalized, they should not be included in the equalization base. All districts would have been penalized by a reduction in the funding base.

18. A comparison of FP schedule funding to actual FY 1988 district expenditures in this size category of schools indicated greater reliance on nonequalized funding and the need to adjust the schedule amount to ensure that equalization for this category resulted in at least 80% of FY 1988 expenditures. This adjustment affected 60% of the state ANB count in 73 of the state's largest elementary school districts.

19. Chapter 4, Special Laws of June 1989. During the regular session, the Governor vetoed the 4% schedule increase in House Bill No. 618, saying that action would not address all the equalization questions before the Legislature.

20. Each year, OPI will calculate the statewide average for the GTB program by dividing the taxable value of all property in the state by the state ANB count. Based on data from the Department of Revenue and the school districts, the Office of Public Instruction will then calculate, by July 1 of each year, each district's "mill value per ANB" by dividing the district or county taxable value by its ANB for the current year. In figuring both the statewide average and the district or county mill value per ANB, all nonlevy revenue--such as interest, tuition, forest reserve funds, and the new flat tax revenue--must be converted to mills. Public Law 81-874 funds are not included in this calculation.

21. Administrative Rules of Montana (ARM) 10.21.101, et seq.

22. The slight difference between county and district statewide averages is the addition of tuition as a nontax revenue source for districts.

23. ARM 10.23.101, et seq.

24. Responses from the State Attorney General to Alan Nicholson, Chairman of the Board of Public Education, dated November 21, 1989, and to Representative Thomas N. Lee, dated April 23, 1990.

25. Helena Elementary.

26. Ibid., page 52, Exhibit 27.

27. "Public Law 81-874 Funding and Equalization in Montana," by Madalyn Quinlan, Montana Office of Public Instruction, November 9, 1990.

28. ARM 10.22.101, et seq.

29. Various funding proposals advocated that retirement benefits for special education personnel be funded as allowable costs rather than being included in the district's retirement obligations to be funded by the county retirement levy.

30. In FY 1988, 73 districts, comprising 35% of the state ANB count, operated school for more than 180 days. Chapter 337, Laws of 1989, changed the method of counting ANB from the previous school fiscal year to a count of the second semester of the previous year and the first semester of the current school year. Thus, the ANB count of a district's FY 1991 GF budget is based on the ANB count for the spring 1989 semester and the fall 1990 semester.

31. Options for Equity and Governor's Public School Finance Advisory Council.

32. In FY 1988, the statewide total for district comprehensive insurance funds was $10.6 million. The average district levy ran at 5 mills.

33. ARM 10.67.101.

34. As introduced, HB 28 would have included these employee benefit costs in the district general fund, with full reimbursement through state equalization aid. Senate Bill No. 26, June 1989 Special Session, would have provided phased-in funding of the district's full retirement obligation within the GF budget. Senate Bill No. 203, vetoed in the 1989 Regular Session, would have funneled state equalization aid to a separate district fund for school personnel retirement benefits.

35. Chapter 635, Laws of 1987.

36. House Bill No. 28, as introduced, provided for a 75-mill county equalization levy and a 45-mill statewide levy.

37. Originally introduced as Senate Bill No. 25, June 1989 Special Session.

38. See especially, House Bill No. 20 (Chapter 10, Special Laws of 1989).

39. Initiative Measure No. 105, approved November 4, 1986.

40. ARM 10.67.102, et seq.

41. ARM 10.30.301 to ARM 10.30.504.

42. The Governor's Public School Finance Advisory Council and House Bill No. 575 of the 1989 Regular Session recommended that transportation be funded in the district

general fund, with equalized state aid granted on a density factor. House Bill No. 28, as introduced, would have provided 100% state funding of the transportation schedules.

43. "School Transportation Laws and Issues," by Andrea Merrill, Montana Legislative Council and Jan Thomson, Montana Office of Public Instruction, January 1990.

"Montana Public School Transportation Status Report for School Year 1988-89," by Jan Thomson, Montana Office of Public Instruction, March 1990.

"How Other States Fund School Transportation," by Andrea Merrill, Montana Legislative Council, May 1990.

44. "Fuel Costs--Estimated Impact of Recent Increases on Public School Transportation," by Jan Thomson, Montana Office of Public Instruction, September 1990.

45. "Montana Public School Transportation Funding Proposals," by Jan Thomson, Montana Office of Public Instruction, November 1990.

46. "Progress Report on School Facility Survey," Office of the Legislative Fiscal Analyst, January 1990.

47. "School Facility Survey," memo from the Office of the Legislative Fiscal Analyst, April 3, 1990.

48. "The State's Role in Equalizing School Facility Funding and Expenditure," by Taryn Purdy, Office of the Legislative Fiscal Analyst, January 1990.

49. "Capital Outlay Equalization," by Taryn Purdy, Office of the Legislative Fiscal Analyst, September 1990.

50. "Capital Outlay Equalization," by Taryn Purdy, Office of the Legislative Fiscal Analyst, November 9, 1990.

51. House Bill No. 575 and the Governor's Public School Finance Advisory Council report.

52. "Montana Public School Tuition Status Report--School Year 1989-90," by Dori Nielson, Montana Office of Public Instruction, September 1990.

53. "The Organization of Montana's School Districts: Encouraging the Goals of Efficiency, Equity, and Educational Opportunity," by Andrea Merrill, Montana Legislative Council, March 1990.

"Montana Public School Organization Status Report--School Year 1989-90," by Dori Nielson, Montana Office of Public Instruction, March 1990.

54. "School District Organization," memo prepared by Dr. Ernest Jean, Superintendent of Florence-Carlton Schools, May 10, 1990.

55. Letter from Representative John Cobb requesting Committee consideration of the school district cooperative sharing program in the State of Iowa. See "Studying School Finance in Iowa: A Study of Iowa School Districts' Cooperative Sharing Programs and Agreements," prepared for the Iowa Interim School Finance Study Committee, November 15, 1988.

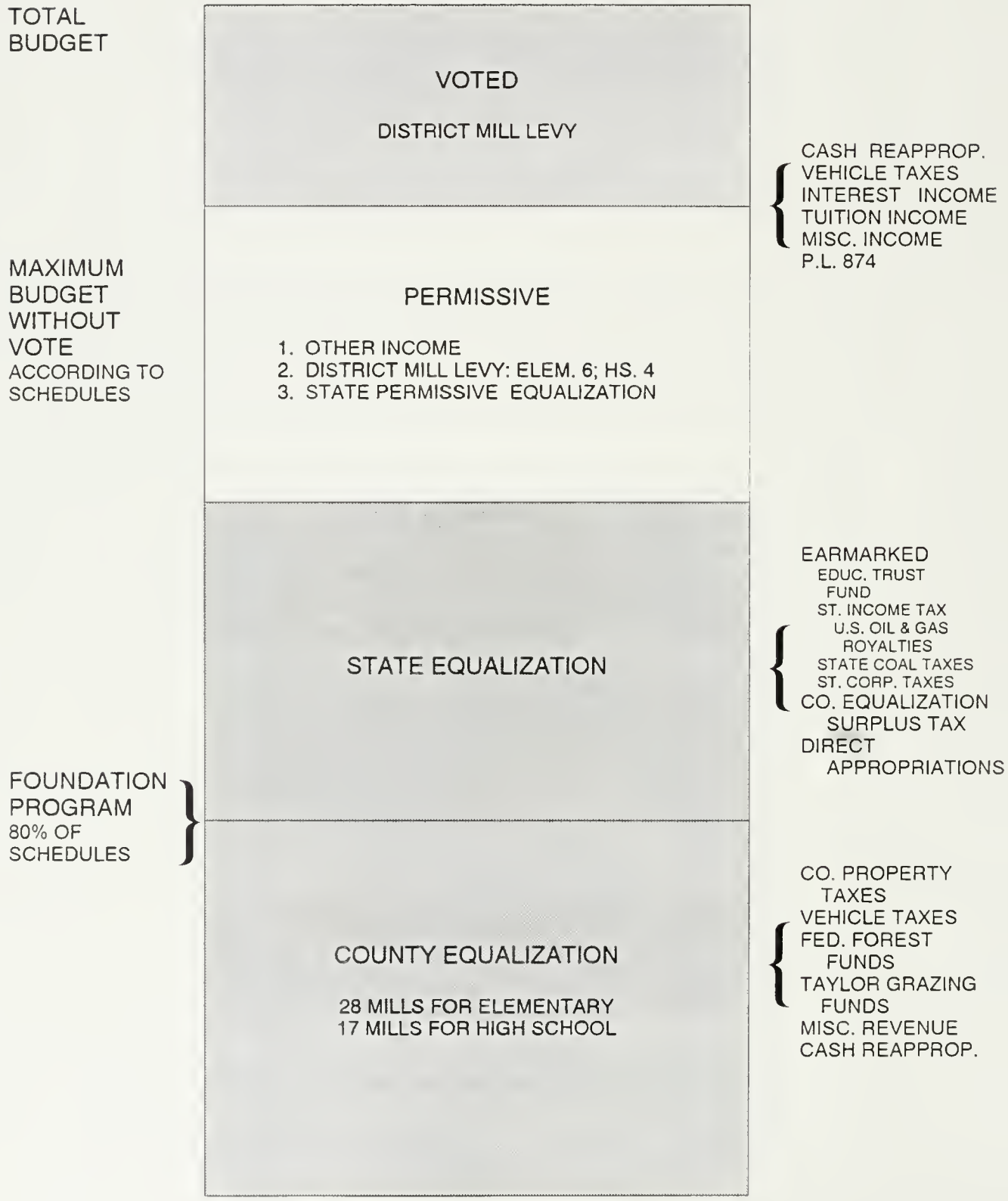
56. Chapter 82, Laws of 1967, enacted as Title 7, chapter 11, MCA, and Chapter 313, Laws of 1969, enacted as Title 20, chapter 9, part 7, MCA.

57. "Final Report for the Montana Educational Telecommunications Project," prepared for the State of Montana by Lambda Communications Inc., Bell Canyon, California, July 12, 1990. Also see "Executive Summary" of the Lambda report.

APPENDIX A

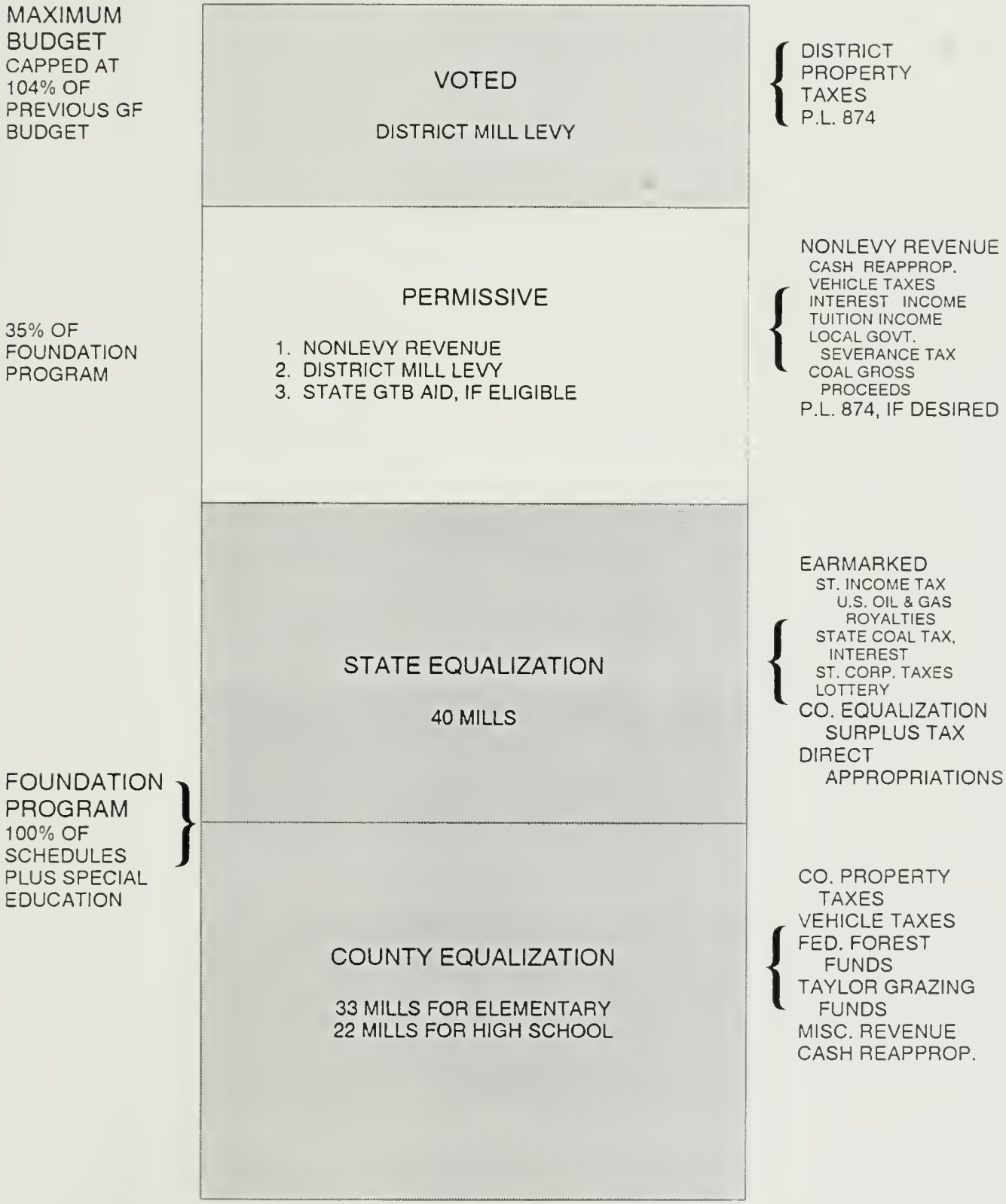
MONTANA PUBLIC SCHOOL

GENERAL FUND STRUCTURE IN FY 1988



MONTANA PUBLIC SCHOOL

GENERAL FUND STRUCTURE IN FY 1991



COMPREHENSIVE INSURANCE COSTS NOW IN GF BUDGET

APPENDIX B

Oil and Gas Severance Tax Corrections
May 1990 Special Session

Senate Bill No. 1 (Chapter 3, Special Laws of 1990) modifies both the taxation of oil and gas production for local government severance tax (LGST) purposes and the distribution of the proceeds from the tax. The bill corrected an inadvertent mistake in House Bill No. 28 (HB 28), the school equalization bill in the June 1989 Special Session, that exempted from the LGST gas stripper wells producing less than 30,000 cubic feet per day.

HB 28 provided that beginning in fiscal year 1991, local severance taxes were to be distributed in accordance with fiscal year 1989 mill levies. However, the unit value formula (net proceeds taxes divided by the number of barrels of oil produced or the number of million cubic feet of natural gas produced) for distributing tax revenue is based on 1988 production and fiscal year 1990 mill levies. Senate Bill No. 1 (SB 1) corrects this inconsistency by establishing fiscal year 1990 as the base year for distribution. HB 28 also directed the Department of Revenue to calculate unit values for oil and natural gas by school district. To ensure that each local government entity received its proper allocation of LGST revenue, the phrase "taxing unit" was substituted for "school district" or "district".

A more significant change to the distribution mechanism involves a percentage adjustment to a taxing unit's allocation if the price of oil or gas varies from the 1988 levels. The importance of this change is that it prevents a "negative" allocation to a taxing unit (that is, the unit owes the state money) if the price of oil or gas in a year is less than the price was in 1988. SB 1 also clarifies that local production taxes on coal, oil, and natural gas are included in the guaranteed tax base for school funding purposes.

The most controversial aspect of SB 1 involved changes in the LGST rates. The Senate version imposed a 12.5% severance tax rate on nonworking interest owners of oil production and a 15.25% rate on

nonworking interest gas production (the same as the working interest owner rate on regular gas production but higher than the stripper gas rate). The purpose of the higher rates on nonworking interest owners is to maintain the relative tax burden between producers and royalty owners as had previously existed under net proceeds taxation. The House, on the other hand, concluded that the rates adopted under HB 28 were insufficient to maintain "revenue neutrality" with respect to net proceeds tax collections. The House version of the bill imposed severance tax rates of 8.93% on all oil production and 16.21% on all gas production, regardless of ownership interests. A free conference committee adopted and both houses concurred in the following LGST rates:

(1) 8.4% on regular oil production;

(2) 5% on stripper and incremental oil production;

(3) 15.25% on regular gas production;

(4) 10% on stripper gas production;

(5) 12.5% on all oil royalties of nonworking interest owners; and

(6) 15.25% on all gas royalties of nonworking interest owners.

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